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SUPREME COURT, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1962

No. 1022 162

SANTA MONICA BANK, and SOUTHWEST BANK OF INGLEWOOD,

Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,

Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

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Petitioners,

v.

SECURITIES AND EXCHANGE COMMISSION,
Respondent.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT.

Petitioners pray that a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit entered herein May 19, 1960.

Opinions Below.

The Opinion of the District Court, 178 F. Supp. 418, is printed at R. 2a-12a.* The Opinion of the United States Court of Appeals for the Second Circuit, not yet officially reported, is printed in Appendix hereto, *infra*, pp. A-1-A-9.

* Record references are to the printed appendices filed by the parties below and submitted here pursuant to Rule 21(3) of this Court.

Jurisdiction.

The judgment of the Court of Appeals was entered on May 19, 1960. The jurisdiction of this Court is invoked under 28 U. S. C., Section 1254.

Question Presented.

The question involved is the right of two banks as bona fide pledgee of unregistered securities to sell after default on the part of the borrower.

Statute Involved.

The statutory provision is the Securities Act of 1933, more particularly Section 4 Subdivision 1 thereof, 15 U. S. C. A. §77 (d)(1).

Statement of the Case.

On September 17, 1958 petitioners jointly made a commitment to lend $120,000 to Hal Roach, Jr., who had submitted a financial statement showing a net worth of $797,750 as of August 31, 1958. Subsequently the loans were made on short term notes, the ultimate collateral being 30,000 shares of stock of F. L. Jacobs Co., then trading on the New York Stock Exchange at approximately $8.00 per share.

On December 9, 1958 the banks learned that the securities of F. L. Jacobs Co. were suspended from trading on the New York Stock Exchange but continued to be traded over-the-counter. The banks advised the borrower that

the loans were not properly collateralized and thereafter undertook extensive negotiations for a renewal of the loans provided the amounts were reduced or additional collateral was forthcoming. An arrangement was made with respect to the nature of the additional collateral, but, over a period of weeks neither payment nor additional collateral was forthcoming to the banks. Accordingly, on January 27, 1959, Petitioner, Southwest Bank of Inglewood, informed Mr. Roach that unless the additional collateral was deposited by three o'clock Tuesday, February 3, 1959, they would call the loan. At this time the F. L. Jacobs Co. stock was selling over-the-counter for at least $5.00 per share.

On February 3, 1959, before the deadline, Mr. Roach advised the banks that he had deposited $75,000 of notes of Guild Films Company, Inc., with their New York correspondent as an evidence of good faith, with an agreement to substitute 50,000 shares of the common stock of Guild Films Company, Inc. by Friday of that week. This deposit was verified by the Chemical Corn Exchange Bank of New York. Accordingly, on February 5, 1959 the banks, relying on their additional collateral and the forthcoming deposit of the stock advised Mr. Roach they would delay action until February 10, 1959. On that date the banks were advised by telegraph that the 50,000 shares had been airmailed to them. Thereupon the banks renewed the loans to March 18, 1959. On this date the F. L. Jacobs Co. stock was still saleable at $5.00 per share.

On February 12, 1959 the Santa Monica Bank received in the mail a certificate for the promised 50,000 shares, and immediately authorized its New York correspondent to release the notes for $75,000. Later that same day the banks learned that the stock of F. L. Jacobs Co. was suspended from all trading whatsoever and thereupon advised Mr. Roach that unless the loan was liquidated by

February 16, 1959 they would have to take steps to sell the stock of Guild Films Company, Inc. which was then the only saleable collateral they held.

After a default by the borrower, the banks attempted to sell 50,000 shares. The transfer agent for Guild Films Company, Inc., refused to transfer the securities. Thereafter an action was commenced in the Supreme Court of the State of New York, New York County, by the Santa Monica Bank against Guild Films Company, Inc., and The Commercial Bank of North America, its transfer agent, to compel the transfer of the stock. A judgment was entered in the Supreme Court on September 18, 1959 ordering the stock transferred to the Santa Monica Bank. Pursuant to this judgment the stock was transferred to the bank and part of the stock was thereafter sold on the American Stock Exchange.

The United States District Court granted a temporary injunction restraining future sales and holding that the Santa Monica Bank was not a bona fide pledgee in the circumstance, acknowledging, however, the rule that a bona fide pledgee may sell unregistered stock after a default. The Court of Appeals in affirming held that regardless of good faith, a pledgee can not sell unregistered securities.

REASONS FOR GRANTING THE WRIT.

I.

A matter of first adjudication with respect to the Securities Act of 1933, Section 4 Subdivision 1.

The case at bar constitutes the first adjudication by an Appellate Court with respect to Section 4 Subdivision 1 of the Securities Act of 1933.

A body of law has developed in the interpretation of the provisions exempting investment securities from registration. Basically the writings of Messrs. Throop & Lane, *Some Problems of Exemption Under the Securities Act of 1933*, and Professor Louis Loss, *Securities Regulation*, 346 (1951), point out that: first, it was the intention of Congress that a bona fide pledgee be free of exemption, since discussion with respect to S. 875, 73rd Cong., 1st Sess. (1933) 126 indicates that language specifically exempting pledgees was withdrawn on the ground that such exemption was unnecessary and redundant; secondly, that the term "underwriter" as defined in the Act, was not intended to apply to a bona fide pledgee.

The Court of Appeals, in its learned opinion, discounts this body of law and proceeds on the theory evolved in the cases of *S. E. C.* v. *Culpepper*, 270 F. 2d 241, *S. E. C.* v. *Chinese Consol. Benev. Assn.*, 120 F. 2d 738 and *Gilligan, Will & Co.* v. *S. E. C.*, 267 F. 2d 461. The gravamen of these cases is generally to set forth what constitutes an underwriting or public offering under the terms of the Act. Since in each of these cases an original issue of securities was involved, the Courts properly held that an attempt to circumvent the registration provisions of the Act was improper. In the case at bar the question does not involve

the original offering of the securities but the subsequent disposition thereof by a bona fide pledgee. Surely if registration is required for the protection of the public at a subsequent sale by a pledgee, then the same logic would compel registration upon each subsequent sale *ad infinitum*. It is only thus that the type of protection of the public suggested by the Court of Appeals could have any meaning.

II.

The interpretation by the Circuit Court of Appeals vitiates the investment exception intended by Congress.

The logical consequence of the decision of the Court of Appeals would be to thwart the normal operation of the business community by making borrowing on investment securities impossible, and completely vitiate the investment exemption intended by Congress.

The process of registration of securities is one which requires technical information available only to the issuer or persons in close business relationship with the issuer. With respect to an outsider, then, it would become impossible and economically prohibitive to effect the registration of investment securities. All the cases cited by the Court of Appeals involved situations where sales were made by persons both close to the corporations and who could have access to information required for registration. These persons properly could have and should have filed effective registration statements.

A lending institution such as the petitioner banks would have no opportunity to file a registration statement in the event of default and accordingly could never dispose of

collateral. This, in turn, would deprive the owners of investment stock of a normal right of a property owner to resort to a pledge when necessary. Furthermore this would in effect limit the investment provisions of Section 4 Subdivision 1 solely to insiders with ready access to the information required to file a registration statement. This result would not be consonant with the intent of Congress or in the public interest in the administration of the Securities Act of 1933.

Conclusion.

The Court of Appeals has rendered a decision in a case of first impression wherein the intent of Congress has been thwarted and which, in effect, limits severely the property rights of individuals by requiring registration of securities which the Act permits to be issued without registration.

Respectfully submitted,

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JACOB RAPOPORT,
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June 16, 1960.

Errata Sheet

The Opinion of the Court of Appeals printed herein as Appendix has been corrected subsequent to the printing hereof as follows:

(1) page A-2—Tenth line from top—"15 U. S. C. A. §77" should read, "15 U. S. C. A. §77(a), *et seq.*"

(2) page A-8—Third line, second paragraph—insert "protecting the investing public through the" before "disclosure".

(3) page A-8—Second paragraph, sixth line, insert single quotes before and after the word "underwriter".

APPENDIX.

Opinion.

UNITED STATES COURT OF APPEALS

FOR THE SECOND CIRCUIT

No. 267—October Term, 1959.

(Argued February 11, 1960 Decided May 19, 1960.)

Docket No. 26039

SECURITIES AND EXCHANGE COMMISSION,
Plaintiff-Respondent,

against

GUILD FILMS COMPANY, INC., SANTA MONICA BANK, SOUTHWEST BANK OF INGLEWOOD, HAL ROACH, JR.,
Defendants-Appellants.

Before:

MOORE, Circuit Judge, and SMITH and HERLANDS, District Judges.

Appeal from an order of the United States District Court for the Southern District of New York, Ryan, Chief Judge, reported at 178 F. Supp. 418, enjoining appellants from selling shares of stock in violation of the Securities Act of 1933, 15 U. S. C. A. § 77(a), *et seq.*

Affirmed.

THOMAS G. MEEKER, General Counsel, Securities and Exchange Commission, Washington, D. C. (Joseph B. Levin, Assistant General Counsel, Arthur Goldman and Frederic G. Gale, on the brief), for Plaintiff-Appellee.

JACOB RAPOPORT, New York, N. Y., for Defendants-Appellants.

MOORE, Circuit Judge:

This is an appeal under 28 U. S. C. A. §1292(a) from an order by the district court, 178 F. Supp. 418, granting a preliminary injunction to restrain the sale of 50,000 shares of Guild Films Company, Inc. common stock by two of the appellants, the Santa Monica Bank and the Southwest Bank of Inglewood. Pending a final determination of this action, the preliminary injunction was issued "unless and until" a registration statement should be filed under the Securities Act of 1933, 15 U. S. C. A. §77.

Section 5[1] of the Act makes it unlawful for anyone, by any interstate communication or use of the mails, to sell or deliver any security unless a registration statement is in effect. Section 4 provides, however, that "the provisions of section 5 * * * shall not apply to * * * (1) Transactions by any person other than an issuer, underwriter, or dealer." The banks claim that they come within this exemption to the registration requirements. The district court rejected this claim, holding that the banks were "underwriters" within the meaning of the Act. While the issue involved can be simply stated, a rather complete discussion of the facts is necessary.

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[1] Sec. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

* * * * * * *

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

The Original Loans by the Banks and the Security Therefor

On September 17, 1958, the Santa Monica Bank and The Southwest Bank of Inglewood jointly agreed to loan Hal Roach, Jr., $120,000, represented by two notes. An unverified, undated financial statement submitted by Roach was relied upon in making the loan. The money was deposited in a joint checking account in the name of Roach and Charles H. Meacham. Roach's note for $60,000 to the Santa Monica Bank, which was to manage the loan for both banks, was dated September 17, 1958, and his note to The Southwest Bank for the same amount was dated September 25, 1958. Both notes were treated as due on December 15, 1958, although the note to The Southwest Bank was actually payable 18 days earlier.

The loans were initially secured by 34,475 shares of the Scranton Corp. (valued at $15 per share) and 2,000 shares of F. L. Jacobs Co. stock (valued at $8 per share). As agreed, this collateral was soon replaced by 30,000 shares of Jacobs stock. Roach had used a large part of the proceeds of the loans to purchase a substantial number of the 30,000 Jacobs shares put up as collateral.

The Jacobs Stock and the Renewal Notes

Roach was an officer, director, and the controlling shareholder of F. L. Jacobs Co., of which Alexander L. Guterma was president. This company controlled the Scranton Corp. which owned Hal Roach Studios, which in turn owned both W-R Corp. and Rabco T. V. Production, Inc.

W-R Corp. and Guild Films, Inc. had made an agreement on January 23, 1959, under which W-R Corp. was to obtain 400,000 shares of Guild Films common stock (the registration of 50,000 shares of this stock is here in dispute) and a number of promissory notes in exchange for certain film properties. The stock was not registered with the S. E. C., but Guild Films agreed to use its best efforts to obtain registration. However, seeking to come within

an exemption provided in section 4 of the Securities Act, the parties provided the following in their agreement:

> "STOCK TAKEN FOR INVESTMENT: W-R warrants, represents and agrees that all of the said 400,000 shares of Guild's common stock being contemporaneously issued hereunder, whether registered in the name of W-R or in accordance with the instructions of W-R, are being acquired for investment only and not for the purpose or with the intention of distributing or reselling the same to others. Guild is relying on said warranty and representation in the issuance of said stock."

On February 5, 1959, for reasons discussed below, Roach directed that 100,000 shares of the Guild Films stock be issued in the name of W-R Corp. and 100,000 shares (represented by two 50,000 share certificates) in the name of Rabco Meacham, the treasurer of Guild Films, directed that the transfer agent stamp this restriction on the stock certificates:

> "The shares represented by this certificate have not been registered under the Securities Act of 1933. The shares have been acquired for investment and may not be sold, transferred, pledged or hypothecated in the absence of an effective registration statement for the shares under the Securities Act of 1933 or an opinion of counsel to the company that registration is not required under said Act."

The remaining 200,000 shares were not issued as the promised film properties were never transferred.

Although the Guild Films stock was issued "for investment only," the district court found that Roach "unquestionably" purchased it in order to have it resold. "In spite of the financial statement submitted by him to the Santa Monica Bank in September, 1958, Roach's financial position at that time was far from secure. A good part of the proceeds of the loan discussed below he had used to purchase Jacobs stock, in turn to post it as collateral for the

loan and to fulfill other stock purchase commitments. Roach was financially pressed in December, 1958, when the Jacobs stock dropped to $5; he apparently had commitments to purchase more of this stock and no money with which to pay for it; he was indebted to the Pacific National Bank in the sum of $55,700 on a note which matured in March, 1959; he was unable to pay the Bank's notes as they matured. Although he sorely needed an extension of time in which to pay, he was unable to deliver sufficient collateral to accomplish this; he held his creditor at bay by promising additional collateral in the form of the Guild Films stock." These findings are uncontested.

On December 9, 1958, the Santa Monica Bank learned that the Jacobs stock had been suspended from trading on the New York Stock Exchange. That bank thereupon wrote to Roach asking him to liquidate the loan before December 15, 1958, because the Jacobs stock, which was then traded over the counter and had dropped in value to $5 per share, was "not now considered by our Loan Committee as acceptable collateral." After a number of conversations, the Santa Monica Bank agreed to renew Roach's note for 90 days upon deposit of 40,000 additional shares of Jacobs stock, or an equivalent in value in Scranton stock or upon payment of $30,000. A renewal note dated December 18, 1958 was sent to Meacham for Roach's signature, and interest on the matured note requested. The Santa Monica Bank agreed to renew on the same conditions. The notes were signed and returned, but Meacham requested "a few days in which to make up our minds" concerning the required additional collateral. Until the end of January, 1959, both banks were in constant communication with Roach, but no further collateral was deposited. On December 31, 1958, The Southwest Bank had informed him that its renewal would not be effective until additional security was supplied, and on January 28, 1959, it wrote to Roach demanding, by February 3, 1959, payment of the November 24, 1958 note, then more than six weeks overdue. On February 3, 1959, Roach telegraphed the Santa Monica Bank that he had "deposited $75,000

Guild Films, Inc. notes to your account at Chemical Corn Bank, New York. This best I can do till I return to Los Angeles next week." On the basis of this telegram, The Southwest Bank wrote to Roach agreeing to defer action until February 10th.

The Guild Films Stock

On that date Roach wired The Southwest Bank that he had sent 50,000 shares of Guild Films stock to the Santa Monica Bank. By a divided vote the Loan Committee of The Southwest Bank decided to renew the note, making it payable "On 'Demand' if 'No Demand' then all due March 18, 1959." On February 12th one of the 50,000 share Guild Films certificates in the name of Rabco T. V. Productions was received by the Santa Monica Bank. The restrictive legend quoted above was stamped on the face of the certificate. Upon receipt thereof, the Santa Monica Bank authorized the Chemical Corn Exchange Bank in New York to release the Guild Films notes.

Subsequent Attempts by the Banks to Sell the Guild Films Stock

On February 12th, the Santa Monica Bank and The Southwest Bank learned that the Jacobs stock had been suspended from all trading by the S. E. C. The Santa Monica Bank immediately telegraphed Roach demanding payment by February 16th, and stating that otherwise the stock would be sold to liquidate the loan. Roach failed to pay and the banks attempted to sell the securities through brokers on the American Stock Exchange.

The Guild Films transfer agent refused to transfer the stock to the banks because of the stamped restriction. The Santa Monica Bank then wired Guild Films that unless the stock was released or exchanged for unrestricted securities, the matter would be taken to the American Stock Exchange and the S. E. C. "for their assistance and release." Guild Films refused to act; it also refused an offer to exchange

the 50,000 shares for 25,000 shares of unrestricted stock; and no application for registration was made to the S. E. C.

In August, 1959, the Santa Monica Bank brought an action against Guild Films in the New York Supreme Court to compel the transfer of the stock. On September 18, 1959, that court ordered the transfer of the stock to the bank. The court based its order on a referee's report which found that the stock was exempt from the Securities Act of 1933. The Santa Monica Bank thereupon ordered 9,500 shares of the Guild Films stock sold. The S. E. C. learned of the sale and notified the bank and Guild Films that the stock could not be sold without registration. The bank then sought a Commission ruling that the stock was exempt. Despite an adverse opinion by the Commission, the bank sold an additional 10,500 shares on September 24, 1959. At that point, the Commission filed this suit to restrain the delivery of these shares and the sale of the remainder of the stock. The district court granted a preliminary injunction against delivery and further sale.

The Securities Act of 1933 was primarily intended to "protect investors by requiring registration with the Commission of certain information concerning securities offered for sale." *Gilligan, Will & Co.* v. *S. E. C.*, 2 Cir. 1959, 267 F. 2d 461, 463. An exemption from the provisions of §5 of the Act was provided by §4(1) for "transactions by any person other than an issuer, underwriter or dealer" because it was felt that no protection was necessary in these situations. See H. R. Rep. No. 85, 73rd Cong., 1st Sess. (1933) at p. 15. The primary question involved in this case is: were appellants issuers, underwriters or dealers within this exemption?

An "underwriter" is defined in §2(11), 15 U. S. C. A. §77b(11), as "any person who has purchased from an issuer with a view to, or sells for an issuer in connection with, the distribution of any security, or participates or has a participation in the direct or indirect underwriting of any such undertaking * * *." The burden of proof is on the one seeking an exemption. *Gilligan, Will & Co.* v. *S. E. C.*, *supra*.

The banks cannot be exempted on the ground that they did not "purchase" within the meaning of §2(11). The term, although not defined in the Act, should be interpreted in a manner complementary to "sale" which is defined in §2(3) as including "every • • • disposition of • • • a security or interest in a security, for value • • •." In fact, a proposed provision of the Act which expressly exempted sales "by or for the account of a pledge holder or mortgagee selling or offering for sale or delivery in the ordinary course of business and not for the purpose of avoiding the provisions of the Act, to liquidate a bona fide debt, a security pledged in good faith as collateral for such debt," was not accepted by Congress. S. 875, 73rd Cong., 1st Sess. (1933) §126. Cf. Throop & Lane, *Some Problems of Exemption Under the Securities Act of 1933*, 4 Law & Contemp. Prob. 89.

Nor is it a defense that the banks did not deal directly with Guild Films. This court has recently stated that "the underlying policy of the Act, that of disclosure of adequate information, would be seriously impaired if we held that a dealer must have conventional or contractual privity with the issuer in order to be an underwriter." *S. E. C.* v. *Culpepper*, 2 Cir., 1959, 270 F. 2d 241, 246, following *S. E. C.* v. *Chinese Consol. Benev. Assn.*, 2 Cir., 1941, 120 F. 2d 738, cert. denied, 314 U. S. 618 (1942). It was held in these two cases that §4(1) "does not in terms or by fair implication protect those who are engaged in steps necessary to the distribution of a security issue. To give §4(1) the construction urged by the defendant would afford a ready method of thwarting the policy of the law and evading its provisions." (*S. E. C.* v. *Chinese Consol. Benev. Assn.*, *supra*, at p. 741.)

The banks have contended that they were "bona fide pledgees" and therefore "entitled upon default to sell the stock free of restrictions." They assume that "good faith" in accepting the stock is a sufficient defense. See Loss, Securities Regulation, 346 (1951). But the statute does not impose such a "good faith" criterion. The exemption in §4(1) was intended to permit private sales of unregistered

securities to investors who are likely to have, or who are likely to obtain, such information as is ordinarly disclosed in registration statements. See *S. E. C.* v. *Ralston Purina Co.*, 346 U. S. 119 (1953). The "good faith" of the banks is irrelevant to this purpose. It would be of little solace to purchasers of worthless stock to learn that the sellers had acted "in good faith." Regardless of good faith, the banks engaged in steps necessary to this public sale, and cannot be exempted.

Without imputing to the banks any participation in a preconceived scheme to use the pledge of these securities as a device for unlawful distribution, it may be noted that when the 50,000 shares of Guild Films stock were received on February 12, 1959, the banks knew that they had been given unregistered stock and that the issuer had specifically forbidden that the stock "be sold, transferred, pledged or hypothecated in the absence of an effective registration statement for the shares under the Securities Act of 1933 or an opinion of counsel to the company that registration is not required under said Act." Furthermore, from Roach's prior unfulfilled promises, the banks should have known that immediate sale was almost inevitable if they were to recoup their loans from the security received. On February 11, 1959, the day before the stock was received, the S. E. C. suspended trading in the Jacobs stock. And on the every day that the stock was received, appellants wired Roach that they would call the loan unless payment were made. For months the banks had threatened action but declined to act; circumstances finally required action. The banks cannot now claim that this possibility was unforeseeable. The district court properly enjoined the threatened violation.

Affirmed.

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In the Supreme Court of the United States

OCTOBER TERM, 1960

SANTA MONICA BANK, AND SOUTHWEST BANK OF INGLEWOOD, PETITIONERS

v.

SECURITIES AND EXCHANGE COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT

BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

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In the Supreme Court of the United States

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SANTA MONICA BANK, AND SOUTHWEST BANK OF INGLEWOOD, PETITIONERS

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BRIEF FOR THE SECURITIES AND EXCHANGE COMMISSION IN OPPOSITION

OPINIONS BELOW

The opinion of the court of appeals is not yet reported (App. A-1 to A-9).[1] The opinion of the district court is reported at 178 F. Supp. 418 (R. 2a-12a).

JURISDICTION

The judgment of the court of appeals was entered on May 19, 1960. The petition for a writ of certiorari

[1] References to the appendix to the petition will be cited as "App." References to the appendix to petitioners' brief in the court below will be cited as "R."

was filed on June 21, 1960. The jurisdiction of this Court is invoked under 28 U.S.C. 1254.

QUESTION PRESENTED

Whether unregistered securities received by the petitioners in connection with loans could be sold to the public without registration pursuant to the Securities Act of 1933 on the ground that the petitioners were not "underwriters."

STATUTE INVOLVED

Sections 4(1), 5, and 2(11) of the Securities Act of 1933, 15 U.S.C. 77e, 77d(1) and 77b(11), are set forth below in the Appendix (*infra*, pp. 9-11).

STATEMENT

The court of appeals affirmed an order granting a preliminary injunction restraining the petitioners, and also Guild Films Company, Inc. ("Guild Films") and Hal Roach, Jr., from selling certain shares of Guild Films stock unless a registration statement is filed under the Securities Act of 1933.

In September 1958, Mr. Roach obtained a short term loan from the petitioners of $120,000, depositing, as collateral, stock of F. L. Jacobs Co. Inc. ("Jacobs"), of which company Mr. Roach was a controlling stockholder, and other stock which was subsequently replaced by more Jacobs stock (R. 3a-4a).

The Jacobs stock having dropped in value as a result of having been suspended from trading on the New York Stock Exchange, the petitioners in December 1958 demanded payment of the loan (R. 4a, 49a). Mr. Roach was in financial difficulties (R. 10a) and had

numerous conversations with the petitioners which resulted only in unfulfilled promises. He neither made payment nor deposited additional collateral, which the petitioners insisted upon as a condition to renewal of the loan (R. 58a). Finally, on January 28, 1959, the banks again demanded payment, this time by February 3.

Meanwhile, on January 23, 1959, a deal was being arranged by Mr. Roach whereby Guild Films was to issue stock and notes to a Roach company, W-R Corp., in exchange for certain film rights (R. 7a). Guild Films agreed to use its best efforts to register these shares under the Act, but, as an interim measure to prevent distribution before registration was effected, Guild Films insisted upon the following condition in the agreement:

> "*Stock Taken for Investment:* W-R warrants, represents and agrees that all of the said 400,000 shares of Guild's common stock being contemporaneously issued hereunder, whether registered in the name of W-R or in accordance with the instructions of W-R, are being acquired for investment only and not for the purpose or with the intention of distributing or reselling the same to others. Guild is relying on said warranty and representation in the issuance of said stock." [R. 7a.]

---

[1] Section 4(1) of the Securities Act exempts from the registration requirements "transactions by an issuer not involving any public offering", the so-called "private offering" exemption relied upon to exempt "private placements." *See Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U. S. 119

On February 3, 1959, the date by which the petitioners had demanded payment, Mr. Roach wired them that he would furnish them 50,000 shares of Guild Films stock. Two days later he persuaded Guild Films to issue a certificate for 50,000 shares. On the instructions of Guild Films, the transfer agent placed the following restrictive legend on the face of the certificate:

> "The shares represented by this certificate have not been registered under the Securities Act of 1933. The shares have been acquired for investment and may not be sold, transferred, pledged or hypothecated in the absence of an effective registration statement for the shares under the Securities Act of 1933 or an opinion of counsel to the company that registration is not required under said Act." [R. 6a.]

The certificate with this legend was delivered to the petitioners, executed in blank on February 12, 1959 (R. 65a). The previous day the Securities and Exchange Commission had suspended all trading in the Jacobs stock so that that stock had no market value. On the day the certificate for the Guild Films stock was received, a Thursday, the petitioners wired Mr. Roach that they were calling the loan and would sell the stock if payment was not received by 8:30 A.M. the following Monday (R. 7a-8a, 66a).

Mr. Roach did not make payment, and the petitioners attempted to sell the stock on the American Stock Exchange, but the transfer agent refused to transfer the

stock because of the restrictive legend. The petitioners, without the knowledge of the Commission, obtained an order in a state court directing a transfer of the stock to them (R. 8a). Thereafter the petitioners commenced a public sale of the Guild Films stock, notwithstanding notice by the staff of the Commission that such sale would be unlawful (R. 12a), whereupon the Commission obtained a preliminary injunction.

ARGUMENT

1. The court below correctly applied the Securities Act in accord with its terms, its purpose, and judicial precedent.

Section 5 of the Act makes it unlawful to sell securities without registration, the means adopted "* * * to protect investors by promoting full disclosure of information * * * necessary to informed investment decisions." *Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U. S. 119, 124. The statute provides no specific exemption for a sale of collateral by a pledgee. Indeed such an exemption was proposed and rejected.[3] Consequently, the petitioners, as they must, rely upon the exemption from registration in Section 4(1) of the Act for "[t]ransactions by any person other than an issuer, underwriter or dealer".[4] This

[3] H. R. 4314 and S. 875, 73d Cong., 1st Sess. (1933). Section 12 (br. Petitioners' suggestion that the rejection of this exemption was because it was unnecessary and redundant is completely unsupported by anything in the legislative history of the Act.

[4] "[T]he burden was upon the petitioners to establish that they were not underwriters within the meaning of § 4(1)." *Gilligan, Will & Co.* v. *Securities and Exchange Commission*, 267 F. 2d 461, 466 (C. A. 2), certiorari denied, 361 U. S. 896, following the rationale of *Securities and Exchange Commission* v. *Ralston Purina Co.*, 346 U. S. at 126.

exemption, however, is not available to the petitioners because they are participants in a public offering and hence "underwriters" within the broad definition of that term in Section 2(11) of the Act, *infra*, p. 11. As the court below pointed out, reaffirming the view it had expressed earlier in *Securities and Exchange Commission* v. *Chinese Consolidated Benevolent Association*, 120 F. 2d 738, 741, certiorari denied, 314 U. S. 618, and in *Securities and Exchange Commission* v. *Culpepper*, 270 F. 2d 241, 246, Section 4(1) "does not in terms or by fair implication protect those who are engaged in steps necessary to the distribution of a security issue. 'To give § 4(1) the construction urged by the defendant would afford a ready method of thwarting the policy of the law and evading its provisions'" (App. A-8).[5]

It is unquestioned that, in the absence of registration of the stock here involved, neither Guild Films nor Mr. Roach could lawfully have undertaken in February 1959 the distribution which the petitioners commenced. The intervention of the petitioners in the distribution process offers no basis for a different statutory consequence. The petitioners stand in no better position under the statute than either Guild Films or Mr. Roach. The congressional mandate of disclosure to investors is not to be set aside to permit a public distribution of non-registered securities because a creditor desires

[5] The petitioners' attempt to distinguish these cases on the ground that they involved "an original issue of securities" is not consistent with the facts in the cases. In any event, the present case involves an issuance of securities originating with the issuer, which the petitioners sought to distribute to the public.

to collect a loan by selling collateral. There is no warrant for subordinating the public interest to this private interest, whether or not the creditor acted in good faith.[8]

2. Moreover, the facts of this case do not involve a bona fide pledge, where the lender takes securities purely as collateral to secure a promise to pay. Here the loan was in default at the time the stock was delivered and it is certainly consistent with the admitted facts to conclude that the lenders realized at the time they accepted the stock that whatever recovery they were to get would come from its distribution. In fact the district court reached the "ultimate conclusion" that this "was not a pledge transaction at all" (R. 109a) and that when the petitioners received the Guild Films stock from Mr. Roach they were "no longer looking for or hoping for payment from him" (R. 114a). The court below did not disagree, but itself stated that "the banks should have known that immediate sale was almost inevitable if they were to recoup their loans from the security received" (App. A 9). Although we believe, as the court below held, that registration would be required even if this had been an ordinary collateral situation, there can be no doubt that regis-

[8] The petitioners' suggestion that a bank can never dispose of collateral in the event of default because it cannot file a registration statement is without basis. If the borrower is neither the issuing corporation nor a person having any relation to the issuer, no problem of registration is involved. If the borrower is the issuer, a person in control of the issuer, or a person who bought from either of them, the bank must tread carefully when it accepts unregistered stock as collateral. A careful bank could and does protect itself in such a situation by requiring a commitment by the issuer that, upon default, registration under the Act will be effected.

tration is required where the securities to be sold were actually transferred and taken with the specific intention that they be distributed in order to obtain repayment of the loan.

CONCLUSION

The decision below is clearly correct. There is no conflict nor need for further review. The petition for certiorari should be denied.

Respectfully submitted.

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JULY, 1960.

APPENDIX

The Securities Act of 1933, 48 Stat. 74, as amended, provides in pertinent part:

* * * *

SEC. 4 (1), 15 U.S.C. § 77d(1):

Exempted Transactions

SEC. 4. The provisions of section 5 shall not apply to any of the following transactions:

(1) Transactions by any person other than an issuer, underwriter, or dealer; transactions by an issuer not involving any public offering; or transactions by a dealer (including an underwriter no longer acting as an underwriter in respect of the security involved in such transaction), except transactions taking place prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter and transactions in a security as to which a registration statement has been filed taking place prior to the expiration of forty days after the effective date of such registration statement or prior to the expiration of forty days after the first date upon which the security was bona fide offered to the public by the issuer or by or through an underwriter after such effective date, whichever is later (excluding in the computation of such forty days any time during which a stop order issued under section 8 is in effect as to the security), and except transactions as to securities constituting the whole or a part of an unsold allotment to or subscription by such dealer as a participant in the distribution of

such securities by the issuer or by or through an underwriter.

SEC. 5, 15 U.S.C. § 77e:

Prohibitions Relating to Interstate Commerce and the Mails

SEC. 5. (a) Unless a registration statement is in effect as to a security, it shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to sell such security through the use or medium of any prospectus or otherwise; or

(2) to carry or cause to be carried through the mails or in interstate commerce, by any means or instruments of transportation, any such security for the purpose of sale or for delivery after sale.

(b) It shall be unlawful for any person, directly or indirectly—

(1) to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to carry or transmit any prospectus relating to any security with respect to which a registration statement has been filed under this title, unless such prospectus meets the requirements of section 10; or

(2) to carry or cause to be carried through the mails or in interstate commerce any such security for the purpose of sale or for delivery after sale, unless accompanied or preceded by a prospectus that meets the requirements of subsection (a) of section 10.

(c) It shall be unlawful for any person, directly or indirectly, to make use of any means or instruments of transportation or communication in interstate commerce or of the mails to offer to sell or offer to buy through the use or medium of any prospectus or otherwise any security, unless a registration statement has been filed as to such security, or while the registration statement is the subject of a refusal order or stop order or (prior to the effective date of the registration statement) any public proceeding or examination under section 8.

Sec. 2(11), 15 U.S.C. § 77b(1):

Definitions

Sec. 2. When used in this title, unless the context otherwise requires—

* * * * * *

(11) The term "underwriter" means any person who has purchased from an issuer with a view to, or offers or sells for an issuer in connection with, the distribution of any security, or participates or has a direct or indirect participation in any such undertaking, or participates or has a participation in the direct or indirect underwriting of any such undertaking; but such term shall not include a person whose interest is limited to a commission from an underwriter or dealer not in excess of the usual and customary distributors' or sellers' commission. As used in this paragraph the term "issuer" shall include, in addition to an issuer, any person directly or indirectly controlling or controlled by the issuer, or any person under direct or indirect common control with the issuer.